

***Trust Fund for the People of the  
Federated States of Micronesia***

Financial Statements

September 30, 2007 and 2006

# ***Trust Fund for the People of the Federated States of Micronesia***

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# ***Trust Fund for the People of the Federated States of Micronesia***

## **Management's Discussion and Analysis**

**For the Fiscal Years Ended September 30, 2007 and 2006**

The following represents the Joint Trust Fund Committee's management discussion and analysis of the Trust Fund for the People of the Federated States of Micronesia's (Trust Fund) financial performance for the years ended September 30, 2007 and 2006. Please read it in conjunction with the Trust Fund's financial statements, which follow this section.

### **The Trust Fund for the People of the Federated States of Micronesia Net Assets Summary**

	<b>September 30,</b>	
	<b>2007</b>	<b>2006</b>
<b>Assets</b>		
Cash and investments	\$122,945,489	\$86,525,037
Accrued investment income	18,248	-
<b>Total Assets</b>	<u>122,963,737</u>	<u>86,525,037</u>
<b>Liabilities</b>		
Accrued expenses	<u>124,154</u>	<u>60,719</u>
<b>Restricted Net Assets</b>	<u><u>\$122,839,583</u></u>	<u><u>\$86,464,318</u></u>

### **Financial Highlights - Net Assets at September 30, 2007**

The fair value of the Trust Fund's net assets was \$122.8 million as of September 30, 2007, compared to \$86.4 million at September 30, 2006. The increase is attributable to the Government of the United States of America contribution of \$17.7 million on October 6, 2006 and net investment income of \$18.7 million.

At September 30, 2007, the Trust Fund's assets were primarily invested in domestic equity common trust funds, international equity common trust funds, and private equity funds.

Accrued expenses represent amounts payable for legal and other professional services incurred during the fiscal year.

# ***Trust Fund for the People of the Federated States of Micronesia***

## **Management's Discussion and Analysis**

**For the Fiscal Years Ended September 30, 2007 and 2006**

### **Financial Highlights - Net Assets at September 30, 2006**

At the end of fiscal year 2006, the Trust Funds Assets were \$86.5 million consisting entirely of contributions from the Governments of the United States of America (United States) and the Federated States of Micronesia and earnings on these funds invested in certificates of deposit. The account was held by Wachovia Bank as custodian for the Trust Fund pending selection of a Trustee.

#### **The Trust Fund for the People of the Federated States of Micronesia Changes in Net Assets Summary**

	<b>Year ended September 30,</b>	
	<b>2007</b>	<b>2006</b>
Contributions	\$17,688,605	\$16,441,694
Net investment income	18,726,375	5,805,289
<b>Total Additions</b>	<b>36,414,980</b>	<b>22,246,983</b>
Administrative expenses	39,715	9,458
<b>Total Deductions</b>	<b>39,715</b>	<b>9,458</b>
<b>Changes in Net Assets</b>	<b>36,375,265</b>	<b>22,237,525</b>
<b>Net Assets - Beginning</b>	<b>86,464,318</b>	<b>64,226,793</b>
<b>Net Assets - Ending</b>	<b>\$122,839,583</b>	<b>\$86,464,318</b>

### **Financial Highlights - Changes in Net Assets for Fiscal Year Ended September 30, 2007**

On October 6, 2006, a contribution of \$17.7 million was made by the Government of the United States. Investment income represents a total weighted return on invested assets, net of investment expenses of \$686,419, for the fiscal year ended September 30, 2007 of approximately 16.51%. Investment advisory fees charged by asset managers vary between approximately 0.4 percent and 0.9 percent of assets under management. The Trust Fund has entered into a cancellable agreement to pay a professional investment advisory firm \$125,000 annually, billed quarterly and indexed to the U.S. Consumer Product Index. The Trust Fund incurred \$126,105 of fees to the investment advisory firm in fiscal year 2007; this amount is included in investment expenses.

The U.S. Department of the Interior contributed staff time, equipment usage and incidental expenses during the fiscal year ended September 30, 2007. No amounts have been recorded in the accompanying financial statements to reflect these transactions since they do not meet the criteria necessary for recognition.

# ***Trust Fund for the People of the Federated States of Micronesia***

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## **Management's Discussion and Analysis**

**For the Fiscal Years Ended September 30, 2007 and 2006**

### **Financial Highlights - Changes in Net Assets for Fiscal Year Ended September 30, 2006**

The Government of the United States contribution of \$16.4 million for fiscal year 2006 was credited to the Trust Fund's account on October 6, 2005. Investment income of \$5,805,289, earned during the fiscal year ended September 30, 2006, net of investment expenses of \$132,040, represents a dollar weighted return on cash and invested assets of approximately 6.99%.

## Independent Auditors' Report

To the Joint Trust Fund Committee  
Trust Fund for the People of the Federated States of Micronesia

We have audited the accompanying statements of net assets of the Trust Fund for the People of the Federated States of Micronesia (a District of Columbia not for profit corporation) as of September 30, 2007 and 2006, and the related statements of changes in net assets for the years then ended. These financial statements are the responsibility of Trust Fund for the People of the Federated States of Micronesia's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the statements of net assets of the Trust Fund for the People of the Federated States of Micronesia as of September 30, 2007 and 2006 and the changes in its net assets for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 22, 2010, on our consideration of the Trust Fund for the People of the Federated States of Micronesia's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

The management's discussion and analysis on pages 1 through 3, are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.



Malvern, Pennsylvania  
February 22, 2010

# ***Trust Fund for the People of the Federated States of Micronesia***

## **Statements of Net Assets**

**September 30, 2007 and 2006**

	<b><u>2007</u></b>	<b><u>2006</u></b>
<b>Assets</b>		
Cash and cash equivalents	\$ 3,370,054	\$ 789,303
Investments, at fair value:		
Domestic equity common trust funds	76,237,264	49,823,198
International equity common trust funds	37,022,353	35,912,536
Private equity funds	<u>6,315,818</u>	<u>-</u>
	119,575,435	85,735,734
Accrued investment income	<u>18,248</u>	<u>-</u>
<b>Total Assets</b>	<b><u>\$122,963,737</u></b>	<b><u>\$86,525,037</u></b>
 <b>Liabilities and Restricted Net Assets</b>		
<b>Liabilities</b>		
Accrued expenses	<u>\$ 124,154</u>	<u>\$ 60,719</u>
<b>Restricted Net Assets</b>	<u>122,839,583</u>	<u>86,464,318</u>
<b>Total Liabilities and Restricted Net Assets</b>	<b><u>\$122,963,737</u></b>	<b><u>\$86,525,037</u></b>

*See notes to financial statements.*

# ***Trust Fund for the People of the Federated States of Micronesia***

## **Statements of Changes in Net Assets**

**Year Ended September 2007 and 2006**

	<b>2007</b>	<b>2006</b>
<b>Additions</b>		
Contributions:		
Government of the United States of America	<u>\$17,688,605</u>	<u>\$16,441,694</u>
Investment income:		
Interest and dividends	2,451,257	3,661,452
Net increase in the fair value of investments	<u>16,961,537</u>	<u>2,275,877</u>
<b>Total Investment Earnings</b>	19,412,794	5,937,329
Less: investment expenses	<u>686,419</u>	<u>132,040</u>
<b>Net Investment Income</b>	<u>18,726,375</u>	<u>5,805,289</u>
<b>Total Additions</b>	<u>36,414,980</u>	<u>22,246,983</u>
<b>Deductions</b>		
Administrative expenses	<u>39,715</u>	<u>9,458</u>
<b>Changes in Net Assets</b>	36,375,265	22,237,525
<b>Net Assets - Beginning</b>	<u>86,464,318</u>	<u>64,226,793</u>
<b>Net Assets - Ending</b>	<u><u>\$122,839,583</u></u>	<u><u>\$86,464,318</u></u>

*See notes to financial statements.*



# ***Trust Fund for the People of the Federated States of Micronesia***

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## **Notes to Financial Statements**

**September 30, 2007 and 2006**

### **Note 1 - Summary of Significant Accounting Policies**

#### **Overview of the Trust Fund:**

##### **Compact**

The Compact of Free Association Between the Governments of the United States of America (United States) and the Federated States of Micronesia and the Republic of the Marshall Islands was approved by the United States Congress in Section 201 of Public Law 99-239 (January 14, 1986) and went into effect with respect to the Federated States of Micronesia on November 3, 1986 as amended by Public Law 108-188 approved December 17, 2003 (Compact) and provided legislation to establish the Trust Fund for the People of the Federated States of Micronesia (Trust Fund).

##### **Trust Fund**

The Compact provides for the establishment of the Trust Fund. Pursuant to the provisions of the Compact and its subsidiary *Agreement Between the Government of the United States of America and the Government of the Federated States of Micronesia* (Original Parties) *Implementing Section 215 and Section 216 of the Compact, as Amended, regarding a Trust Fund* (Trust Fund Agreement), the *Trust Fund for the People of the Federated States of Micronesia* was incorporated in Washington, D.C. on August 17, 2004, as a nonprofit corporation. The purpose of the Trust Fund is to contribute to the economic advancement and long-term budgetary self-reliance of the Federated States of Micronesia by providing an annual source of revenue through fiscal year 2023. After fiscal year 2023, the Trust Fund will provide an annual source of revenue for assistance in specific sectors described in Section 211 of the Compact, or other sectors as mutually agreed by the Original Parties, with priorities in education and health care. In accordance with the agreement, the situs of the Trust Fund was established within the United States. The Original Parties are committed to contribute to the Trust Fund amounts described in the Compact, subsequent contributors may contribute to the Trust Fund if first approved by all Joint Trust Fund Committee (Committee) voting members. By a majority vote of the Committee, other voting or non-voting members may be appointed from Subsequent Contributors that contribute to the Trust Fund from time to time, provided that the United States maintains the majority vote in the Committee.

After the initial twenty (20) years beginning October 1, 2023, the Original Parties will consult regarding the future composition of the Committee. The Committee shall remain the same, unless otherwise agreed by the Original Parties.

The composition of the Committee consists of three voting members from the United States appointed by the Government of the United States, which include the Chairman of the Joint Trust Fund Committee, two voting members appointed by and for the Government of the Federated States of Micronesia. The Committee has the authority to make decisions, appoint administrators and managers, and significantly influence operations. It also has the primary accountability for fiscal matters.

# ***Trust Fund for the People of the Federated States of Micronesia***

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## **Notes to Financial Statements**

**September 30, 2007 and 2006**

### **Note 1 - Summary of Significant Accounting Policies (Continued)**

#### **Trust Fund (Continued)**

The Government of the United States may unilaterally withdraw the accumulated market value of its contributions from the Trust Fund, plus any undistributed income under certain circumstances which include the Government of the Federated States of Micronesia's gross misuse of the Trust Fund's financial resources. The Trust Fund's operations may be terminated by written agreement of the Original Parties.

#### **Tax Exempt Status**

As provided by the Compact, the Trust Fund is exempt from income tax.

#### **Trust Fund Financial Statements**

The statement of net assets and the statement of changes in net assets are private purpose trust financial statements. They report information on all of the Trust Fund's assets, liabilities, net assets, and activities. Trust Fund activities are supported primarily by contributions by the Original Parties and investment income. The Trust Fund has no business or proprietary type activities that rely on fees and charges for support.

Contributions represent amounts paid by the Original Parties to help meet the operational requirements of the Trust Fund and represent principal.

The financial statements provide information on the net assets and changes in net assets of the Trust. The Trust Fund is designed to contribute to the long-term budgetary self-reliance of the Federated States of Micronesia by establishing a trust fund to provide the Government of the Federated States of Micronesia with an ongoing source of revenue after Fiscal Year 2023; recognizing that it is the mutual intention of the Governments of the United States and the Federated States of Micronesia that the Government of the United States discontinue annual grant assistance beyond fiscal year 2023. The Trust Fund consists of three accounts the "A" Account, the "B" Account, and the "C" Account, respectively (collectively, the Accounts). Each account has a specific purpose with respect to the use of contributions and income derived from investments as specified by the Trust Fund Agreement in accordance with the special purpose of the Trust Fund.

#### **Measurement Focus, Basis of Accounting, and Financial Statement Presentation**

The Trust Fund financial statements use the economic resources measurement focus and are prepared using the accrual basis of accounting. Contributions are recorded when due and expenses are recorded when a liability is incurred, regardless of the timing of the related cash flows. Additional contributions are recognized as revenue as soon as all eligibility requirements imposed by the Compact have been met. Investment earnings are recorded as earned, since they are both measurable and available.

The Trust Fund has adopted applicable Government Accounting Standards Board (GASB) pronouncements. With this measurement focus, all assets and all liabilities associated with the operation of the Trust Fund are included in the accompanying statements of net assets. The Trust Fund's net assets are restricted for future use after fiscal year 2023.

# ***Trust Fund for the People of the Federated States of Micronesia***

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## **Notes to Financial Statements**

**September 30, 2007 and 2006**

### **Note 1 - Summary of Significant Accounting Policies (Continued)**

#### **Cash Equivalents**

The Committee considers all highly liquid financial instruments with maturities of three months or less when purchased to be cash equivalents. The Trust Fund's policy is to report cash equivalents at cost, which approximates fair value. Although the money market funds seek to preserve the value of the investment at \$1.00 per share, it is possible to lose money investing in these funds.

#### **Investments**

Common Trust Fund investments are reported at fair value of the underlying investments based upon quoted market values unless a contract guarantees a higher value. Investment income consists of interest, dividends and net investment gains (if any) resulting from increases in the fair value of investments. Private equity funds consist of investments in equity and convertible debt securities for which no active market exists. The underlying investments held by each private equity fund are generally determined by management of the equity investee or as determined by the general partner or management of the private equity funds.

#### **Portfolio Securities on Loan**

The Trust Fund loans securities to certain brokers. Upon such loan, the Trust Fund receives collateral which is maintained by the broker and either earns or pays a negotiated lender's fee on such loaned securities which is included as a reduction of investment expense, in the statement of changes in net assets. The Trust Fund receives collateral primarily in the form of cash. Credit risk arises upon entering into a securities lending transaction to the extent that the value of the collateral is less than the value of the securities loaned due to changes in the value of loaned securities.

#### **Restricted Net Assets**

Restricted net assets consist of the "A", "B", and "C" Accounts as described below are subject to legal, regulatory, budgetary, or other restrictions in accordance with the Compact.

1. The "A" Account:
  - a. The "A" Account, which established upon the effective date of the Compact, as amended, shall form the Corpus and consist of contributions from the Original Parties and subsequent contributors. Except as otherwise provided in the Trust Fund Agreement, it also consists of the income from the investments made from contributions (principal), and transfers from the "B" Account and "C" Account in accordance with the Trust Fund Agreement.

# ***Trust Fund for the People of the Federated States of Micronesia***

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## **Notes to Financial Statements**

**September 30, 2007 and 2006**

### **Note 1 - Summary of Significant Accounting Policies (Continued)**

#### **Restricted Net Assets (Continued)**

- b. Through September 30, 2022, payment of allowable expenses of the Trust Fund shall be made from the "A" Account. During this period, the amount, if any, of income in each fiscal year which remains after such payment of expenses shall be reinvested into the "A" Account. Except as provided in the Trust Fund Agreement, or upon termination of the Trust Fund, no funds may be removed from the "A" Account.

Total amounts included in the "A" Account as of September 30, 2007 and 2006, were \$110,126,326 and \$85,645,392, respectively.

#### **2. The "B" Account:**

- a. On October 1, 2022, the "B" Account shall be created.
- b. During fiscal year 2023, all income earned in fiscal year 2023 shall be deposited into the "B" Account for disbursement in fiscal year 2024.
- c. For fiscal year 2024, and thereafter, the "B" Account shall consist of the prior year's income from investment of funds in the "A" Account.

#### **3. The "C" Account:**

- a. Shall be created at the same time as the "A" Account, and beginning in fiscal year 2004 through fiscal year 2022, any annual income on the Fund over six percent (6%) shall be deposited in the "C" Account, up to the limit specified in (b) below. Beginning in fiscal year 2023, the "C" Account shall be replenished from the "B" Account in accordance with paragraph 6 below;
- b. Shall contain no more than three times the estimated equivalent of the fiscal year 2023 annual grant assistance, including estimated inflation calculated in accordance with Section 217 of the Compact. Any excess above the estimated amount shall return to the "A" Account; and
- c. May be drawn on, to the extent it contains sufficient funds, to address any shortfall in the "B" Account after fiscal year 2023, if income on the "A" Account falls below the previous year's distribution (not including any amount distributed that year for special needs) adjusted for inflation to the Government of the Federated States of Micronesia and for special needs agreed to by the Committee.

# ***Trust Fund for the People of the Federated States of Micronesia***

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## **Notes to Financial Statements**

**September 30, 2007 and 2006**

### **Note 1 - Summary of Significant Accounting Policies (Continued)**

#### **Restricted Net Assets (Continued)**

At September 30, 2007, the "C" Account had not yet been funded. Total amounts allocated to the "C" Account during the years ended September 30, 2007 and 2006 were \$11,894,331 and \$818,926, respectively. The actual amount that will ultimately be transferred to the "C" Account will be determined by the Joint Trust Fund Committee based on actual cumulative investment performance through the date of the transfer.

4. After fiscal year 2023, if the income in the "B" Account is less than the previous year's distribution to the Government of the Federated States of Micronesia, and the "C" Account cannot cover the shortfall in the "B" Account, then the principal and reinvested income not available for distribution (corpus) shall not be accessed to compensate for the shortfall.
5. The Committee may disburse to the Government of the Federated States of Micronesia from the "B" Account (supplemented from the "C" Account if the "B" Account is insufficient):
  - a. In fiscal year 2024, an amount equal to the annual grant assistance provided by the Government of the United States to the Government of the Federated States of Micronesia in fiscal year 2023, plus an inflation adjustment; and
  - b. Beginning in fiscal year 2025 and thereafter, an amount of funds no more than the amount equal to the United States annual financial assistance to the Federated States of Micronesia in fiscal year 2023 plus a cumulative inflation adjustment thereon, plus any additional amounts for special needs as approved above.
6. Beginning in fiscal year 2023, the Committee shall transfer to the "A" Account any funds in the "B" Account in excess of the amount approved for disbursement in the following fiscal year, in accordance with paragraph 5 above, unless such excess funds are needed to bring the "C" Account to its maximum permitted level.
7. A special account, ("D" Account), may be established to allow contribution by the Federated States of Micronesia for revenues or income from unanticipated sources. This account shall not be commingled with the Trust Fund and must have a separate account number. The Federated States of Micronesia shall have access to funds in this account for unanticipated shortfalls or other purposes. Funds in this account are not part of the Trust Fund corpus and are not under the control of the Joint Trust Fund Committee. There were no contributions to the "D" Account during the periods presented in the accompanying financial statements.

# ***Trust Fund for the People of the Federated States of Micronesia***

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## **Notes to Financial Statements**

**September 30, 2007 and 2006**

### **Note 1 - Summary of Significant Accounting Policies (Continued)**

#### **Estimates**

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

### **Note 2 - Contributions**

The Government of the United States shall contribute to the Trust Fund annually for twenty years from the effective date of the Compact, amounts set forth in Section 216 of the Compact. Upon termination of the annual financial assistance under Section 211 of the Compact, the proceeds of the Trust Fund shall thereafter be used for the purposes described in Section 211 of the Compact or as otherwise mutually agreed by the Original Parties.

The Government of the United States contribution to the Trust Fund was conditioned on the Government of the Federated States of Micronesia contributing at least \$30 million to the Trust Fund, prior to September 30, 2004. Any funds received by the Government of the Federated States of Micronesia under Section 111 (d) of Public Law 99-239 (January 14, 1986), or successor provisions, would be contributed to the Trust Fund as a Government of the Federated States of Micronesia contribution.

A history of contributions to the Trust Fund's "A" Account is as follows:

<b>Date</b>	<b>Amount (Millions)</b>	<b>Contributor</b>
October 1, 2004	\$30.3	Federated States of Micronesia
October 5, 2004	32.2	United States
October 6, 2005	16.4	United States
October 6, 2006	17.7	United States
<b>Total Contributions through Fiscal Year 2007</b>	<u><u>\$96.6</u></u>	

# ***Trust Fund for the People of the Federated States of Micronesia***

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## **Notes to Financial Statements**

**September 30, 2007 and 2006**

### **Note 2 - Contributions (Continued)**

Past received and future scheduled contributions to the Trust Fund “A” Account by the Government of the United States during the Trust Fund period are as follows:

<b><u>Fiscal Year</u></b>	<b><u>Amount (Millions)</u></b>
2004	\$16.0
2005	16.2
2006	16.4
2007	17.7
2008	17.6
2009	18.4
2010	19.2
2011	20.0
2012	20.8
2013	21.6
2014	22.4
2015	23.2
2016	24.0
2017	24.8
2018	25.6
2019	26.4
2020	27.2
2021	28.0
2022	28.8
2023	29.6

The amounts of scheduled contributions as shown are subject to an inflation adjustment for each United States fiscal year by the percent that equals two-thirds of the percent change in the United States Gross Domestic Product Implicit Price Deflator, or 5 percent, whichever is less in any one year, using the beginning of fiscal period 2004 as a base.

Contributions to the “D” Account are not reflected in the accompanying financial statements. As described in Note 1, the “D” Account was set up to allow for additional income to the Trust Fund from unanticipated sources. These contributions may not be commingled with assets of the Trust Fund and are required to have a separate account number. The Government of the Federated States of Micronesia has access to funds in this account for unanticipated shortfalls or other purposes. Funds in the “D” Account are not part of the corpus of the Trust Fund for the People of the Federated States of Micronesia.

# Trust Fund for the People of the Federated States of Micronesia

## Notes to Financial Statements

September 30, 2007 and 2006

### Note 3 - Investments

During 2007 and 2006, the Trust Fund realized net gains from the sale of investments of \$4,463,373 and \$-0-, respectively. The calculation of net realized investment gains is independent of the calculation of the net increase in the fair value of investments. Realized gains and losses on investments that had been held in more than one fiscal year and sold in the current year may have been recognized as an increase or decrease in the fair value of investments reported in the prior year. The net increase in the fair value of investments during the fiscal years ended September 30, 2007 and 2006 was \$16,961,537 and \$2,275,877, respectively. This amount takes into account all changes in fair value that occurred during the year. The net unrealized gain on investments held at September 30, 2007 and 2006 was \$14,774,041 and \$2,275,877, respectively.

Investment Security	Cost	Fair Value				Ending Fair Value 9/30/07	Change in Fair Value
		Beginning Fair Value 10/1/06	Purchases	Sales	Subtotal		
<b>2007</b>				(In Thousands)			
Cash equivalents	\$ 3,370	\$ 789	\$ 50,621	\$ 48,040	\$ 3,370	\$ 3,370	\$ -
Domestic Equity							
Common Trust							
Funds	67,378	49,823	36,164	19,269	66,718	76,237	9,519
International							
Equity Common							
Trust Funds	31,573	35,913	31,573	37,459	30,027	37,022	6,995
Private equity funds	5,850	-	7,244	1,375	5,869	6,316	447
	<u>\$108,171</u>	<u>\$ 86,525</u>	<u>\$125,602</u>	<u>\$106,143</u>	<u>\$105,984</u>	<u>\$122,945</u>	<u>\$16,961</u>

Investment Security	Cost	Fair Value				Ending Fair Value 9/30/06	Change in Fair Value
		Beginning Fair Value 10/1/05	Purchases	Sales	Subtotal		
<b>2006</b>				(In Thousands)			
Cash equivalents	\$ 789	\$ -	\$ 789	\$ -	\$ 789	\$ 789	\$ -
Domestic Equity							
Common Trust							
Fund	47,533	-	47,533	-	47,533	49,823	2,290
International							
Equity Common							
Trust Funds	35,927	-	35,927	-	35,927	35,913	(14)
	<u>\$84,249</u>	<u>\$ -</u>	<u>\$84,249</u>	<u>\$ -</u>	<u>\$84,249</u>	<u>\$86,525</u>	<u>\$2,276</u>



# ***Trust Fund for the People of the Federated States of Micronesia***

## **Notes to Financial Statements**

**September 30, 2007 and 2006**

### **Note 3 - Investments (Continued)**

The Trust Fund has an investment policy which has been established to reflect the growth objectives and risk tolerance of the Committee. The investment policy also permits a portion of the Trust Fund to engage in currency hedging and make investments in alternative investments. Not more than 5% of the Trust Fund's assets may be invested in any one security without specific consideration and approval by the Committee, except for United States Treasury and Agency Obligations. Investment risk will be limited by appropriate diversification between and within asset classes. The current investment policy includes the following parameters:

<b>Investment Class</b>	<b>Immediate</b>	<b>Short-Term</b>	<b>Intermediate</b>	<b>Long-Term</b>
Domestic All Cap Equity	57.0%	40.0%	24.0%	0.0%
Domestic Large Cap Equity	0.0%	0.0%	0.0%	15.0%
Domestic Small Cap Equity	0.0%	0.0%	0.0%	5.0%
Non-US Equity - Developed Markets	43.0%	30.0%	18.0%	15.0%
Non-US Equity - Emerging Markets	0.0%	0.0%	8.5%	7.5%
Non-US Equity - Small Cap	0.0%	0.0%	0.0%	3.0%
Fixed Income Aggregate	0.0%	15.0%	17.5%	0.0%
Emerging Market Debt	0.0%	0.0%	8.5%	7.5%
Private Equity	0.0%	15.0%	16.0%	12.5%
Convertible Bonds	0.0%	0.0%	0.0%	2.5%
Real Estate - Private	0.0%	0.0%	7.5%	19.5%
Commodities	0.0%	0.0%	0.0%	10.0%
Hedge Fund - Aggressive	0.0%	0.0%	0.0%	2.5%

The four phases of the asset allocation are outlined above. The short-term was intended to be accomplished over the twelve month period following Trust Fund Committee approval, effective March 23, 2006, intermediate-term over the two year period following approval, and long-term within four years. The implementation periods are subject to considerations in finding suitable managers, as well as assets available for investment. At the financial reporting date, the Trust Fund was in the short-term phase of the asset allocation plan.

<b>Investment Class</b>	<b>% of Fund Strategic</b>	<b>% of Fund Tactical Range</b>	<b>Actual % of Trust Fund at 9/30/07</b>
Domestic All Cap Equity	40.0%	40.0% - 57.0%	48.0%
Non-US Equity - Developed Markets	30.0%	18.0% - 43.0%	30.1%
Fixed Income Aggregate	15.0%	0.0% - 15.0%	14.0%
Private Equity	15.0%	0.0% - 15.0%	5.1%

## September 30, 2007 and 2006

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# *Trust Fund for the People of the Federated States of Micronesia*

## Notes to Financial Statements

September 30, 2007 and 2006

### Note 3 - Investments (Continued)

Currency	Fair Value		
	Common Trust Funds	Private Equity Funds	Total
<b>2007 (Continued)</b>		(In Thousands)	
Norwegian Krone	643	-	643
Pakistani Rupee	13	-	13
Panamanian Balboa	11	-	11
Peruvian Nuevo Sol	40	-	40
Philippine Peso	16	-	16
Polish Zloty	30	-	30
Russian Ruble	423	-	423
Serbian Dinar	14	-	14
Singapore Dollar	1,147	-	1,147
South African Rand	224	-	224
South Korean Won	566	-	566
Swedish Krona	1,845	-	1,845
Swiss Franc	3,645	-	3,645
Taiwan New Dollar	286	-	286
Thai Baht	165	-	165
Tunisian Dinar	3	-	3
Turkish Lira	43	-	43
Ukraine Hryvnia	4	-	4
Uruguayan Peso	26	-	26
Venezuelan Bolivar	31	-	31
	<u>\$37,777</u>	<u>\$1,595</u>	<u>\$39,372</u>

Currency	Fair Value
	Common Trust Funds
<b>2006</b>	(In Thousands)
Australian Dollar	\$ 1,817
British Pound	7,741
Danish Krone	272
European Euro	12,513
Hong Kong Dollar	574
Japanese Yen	8,324
New Zealand Dollar	55
Norwegian Krone	257
Swedish Krona	844
Singapore Dollar	303
Swiss Franc	<u>2,656</u>
	<u>\$35,356</u>

# ***Trust Fund for the People of the Federated States of Micronesia***

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## **Notes to Financial Statements**

**September 30, 2007 and 2006**

### **Note 4 - Commitments**

At September 30, 2007, the Trust Fund had capital funding commitments relating to its investments in private equity funds of \$25,757,080. Capital commitments, capital contributions, and unfunded capital commitments at September 30, 2007 were as follows:

	<b><u>Capital Commitments</u></b>	<b><u>Capital Contributions</u></b>	<b><u>Unfunded Capital Commitments</u></b>
Private Equity Funds	<u>\$25,757,080</u>	<u>\$6,954,646</u>	<u>\$18,802,434</u>

### **Note 5 - Subsequent Event**

Subsequent to September 30, 2007, the fair value of invested assets held by the Trust Fund at September 30, 2007 decreased significantly. At December 31, 2009, the fair value of the Trust Fund's invested assets was \$163,735,743, inclusive of capital contributions, net of investment fees and administrative expenses of \$59,920,164, subsequent to September 30, 2007, which were primarily funded by fiscal years 2008, 2009, and 2010 contributions from the Government of the United States. The subsequent period decrease in fair value of the Trust Fund's invested assets represents a decline of approximately \$19,129,910 of the Trust Fund's total invested assets as of September 30, 2007, as reported in the accompanying financial statements.

**Independent Auditors' Report on Internal Control over Financial  
Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements  
Performed in Accordance with Government Auditing Standards**

To the Joint Trust Fund Committee  
Trust Fund for the People of the Federated States of Micronesia

We have audited the accompanying statement of net assets of Trust Fund for the People of the Federated States of Micronesia (a District of Columbia not for profit corporation herein after referred to as Trust Fund) as of September 30, 2007, and the related statement of changes in net assets for the year then ended, and have issued our report thereon dated February 22, 2010. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

**Internal Control Over Financial Reporting**

In planning and performing our audit, we considered Trust Fund's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Trust Fund's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Trust Fund's internal control over financial reporting.

Our consideration of the internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects Trust Fund's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of Trust Fund's financial statements that is more than inconsequential will not be prevented or detected by Trust Fund's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material misstatement of the financial statements will not be prevented or detected by Trust Fund's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that none of the significant deficiencies described below is a material weakness.

We consider the following deficiencies to be significant deficiencies in internal control:

***Condition #1:***

The lack of adequate record keeping does not allow management to properly determine and disclose the amount of annual deposit, which may be required to be made to the “C” account or the balance of the “C” Account in the Trust Fund’s financial statements.

***Criteria:***

The Compact Subsidiary Agreement requires that any annual net increase in the Trust Fund’s net assets, exclusive of contributions to the Trust Fund, in excess of six percent (not to exceed a maximum limit) be deposited into the “C” Account.

***Cause of Condition:***

The Trust Fund Committee engaged the services of a contract accounting service to prepare basic accounting records; however, the Committee did not engage the contract accounting service to calculate the annual increase in net assets, exclusive of contributions, necessary to determine the amount of deposit into the “C” Account which might be required.

***Effect of Condition:***

The Trust Fund’s inability to calculate the annual increase in its net assets, exclusive of contributions, necessary to determine the amount of deposit into the “C” Account which might be required resulted in the Trust Fund’s inability to timely comply with this requirement of the Compact Subsidiary Agreement for fiscal year ended September 30, 2007. Accordingly, the independent auditor prepared this calculation for disclosure in the financial statements, and management reviewed and approved the calculation.

***Recommendation:***

We recommend that the Joint Trust Fund Committee contract with a third party to calculate the annual increase in net assets, exclusive of contributions, in accordance with the Compact Subsidiary Agreement so that amounts can be properly transferred to the “C” Account on a timely basis.

***Management’s Views and Planned Corrective Action:***

The Joint Trust Fund Committee concurs with this recommendation and has agreed to implement as soon as practicable. The Committee has commenced discussions with its contract accounting service and has determined that this service can be provided by the contract accounting service commencing with fiscal year ended September 30, 2009.

***Evaluation of Management’s Comments and Planned Corrective Action:***

The independent auditor has reviewed the Trust Fund Committee’s corrective action plan and believes it to be a viable course of action.

***Condition #2:***

The Trust Fund is not capable of preparing full disclosure financial statements in accordance with accounting principles generally accepted in the United States of America (GAAP), including Government Accounting Standards (GAS) promulgated by the Government Accounting Standards Board.

***Criteria:***

The financial statement audit is performed in accordance with generally accepted auditing standards and requires the auditor to issue an opinion on whether the financial statements are presented in accordance with GAAP, including all financial statement disclosures required by GAAP and GAS.

***Cause of Condition:***

Although the Joint Trust Fund Committee engaged the services of a contract accounting service to maintain certain accounting records and prepare basic accounting statements, the Committee did not engage the contract accounting service to prepare annual full disclosure financial statements in accordance with GAAP and GAS requirements. Furthermore, the contract accounting service did not receive the appropriate level of investment expense detail from the respective money managers in order to track the cost basis of investments, investment expenses, and prepare accrual basis financial statements.

***Effect of Condition:***

Full disclosure financial statements were not available during the audit process. As a result, financial statement disclosures were prepared by the independent auditor and reviewed and approved by the Joint Trust Fund Committee. Additionally, certain investment expenses were incorrectly recorded as a component of investment gains (losses). An audit adjustment was required to correct the misposting and properly account for investment expenses as a reduction of investment income while reporting investment gains and losses exclusive of investment expenses. Further, the independent auditor identified material audit adjustments related to the reclassification of cost basis, investment expenses, and unrealized gains (losses) of approximately \$500,000.

***Recommendation:***

We recommend that the Joint Trust Fund Committee arrange for the preparation of accrual basis, full disclosure financial statements in accordance with U.S. generally accepted accounting principles (including government accounting principles) prior to the commencement of the annual audit.

***Management's Views and Planned Corrective Action:***

The Trust Fund Committee concurs with this recommendation and has agreed to implement as soon as practicable. The Committee has commenced discussions with its investment custodian to determine if this service can be provided by the custodian.

***Evaluation of Management's Comments and Planned Corrective Action:***

The independent auditor has reviewed the Joint Trust Fund Committee's corrective action plan and believes it to be a viable course of action. The timely availability of annual full disclosure financial statements prior to the scheduled commencement of the annual audit is critical to the Trust Fund's ability to comply with the reporting provisions of the Compact Subsidiary Agreement, which require the audited financial statements to be included with the Trust Fund's Annual Report. The Annual Report is due six months following the end of the Trust Fund's fiscal year.

***Condition # 3:***

During our auditing procedures, we observed that the Trust Fund does not maintain original, approved Joint Trust Fund Committee meeting minutes in one central location.

***Criteria:***

The independent auditor identified the Joint Trust Fund Committee's approval process at quarterly meetings, including the documentation of actions authorized or ratified at these meetings as the key control over the Trust Fund's investment transactions and investment policy related to investment allocation parameters by permitted investment type. Maintaining original approved meeting minutes of an entity's governing body is a generally accepted corporate governance best practice.

***Cause of Condition:***

While the Trust Fund Administrator maintains the Joint Trust Fund Committee meeting minutes in electronic format, the Administrator does not maintain permanent documentation of each final version as approved the Committee. Additionally, the Committee does not formally approve the minutes of the preceding Joint Trust Fund Committee meeting.

***Effect of Condition:***

Unauthorized investment transactions and/or allocations could potentially occur and thereby subject the Trust Fund to unacceptable and or/ unanticipated levels of investment risk. Additionally, it might be difficult to determine if the Committee minutes are in fact an approved final version of the proceedings of any particular Committee meeting.

***Recommendation:***

The independent auditor recommends that all minutes of every Joint Trust Fund Committee meeting be properly documented, including the approval of the prior Committee meeting minutes. A permanent original of the approved minutes should typically include the original signatures of two Committee Members and should be maintained in a central repository indefinitely. This practice will provide evidence that all significant matters and resolutions of the Committee have been properly documented and memorialized and that the Committee minutes are, in fact, an approved final version of the proceedings of each Committee meeting.

***Management's Views and Planned Corrective Action:***

The Joint Trust Fund Committee concurs with this recommendation and had agreed to implement this recommendation effective in February 2009.

***Evaluation of Management's Comments and Planned Corrective Action:***

We will evaluate the effectiveness of the implementation of the Joint Trust Fund Committee's corrective action plan during the audit of the Trust Fund's financial statements as of and for the year ended September 30, 2009.

These significant deficiencies were considered in determining the nature, timing, and extent of the audit tests applied in our audit of the Trust Fund's financial statements as of and for the year ended September 30, 2007, and this communication does not affect our report on those financial statements dated February 22, 2010. We have not considered internal control since the date of our report.

The following recommendation is not considered to be a significant deficiency in internal control, but is a suggestion for improvement in operating procedure:

ParenteBeard LLC recommends that periodically, an appropriate member of the Trust Fund Committee or another appropriate person review the Trust Fund's investment composition for compliance with restrictions or limitations imposed by the Trust Fund's Subsidiary Agreement and the Trust's current investment policy.

**Compliance and Other Matters**

As part of obtaining reasonable assurance about whether Trust Fund's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.



This report is intended solely for the information and use of the Joint Trust Fund Committee, management, and Governments of the United States of America and the Federated States of Micronesia and is not intended to be and should not be used by anyone other than these specified parties.

*ParenteBeard LLC*

Malvern, Pennsylvania  
February 22, 2010